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FOR YOUR INFORMATION

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22 July 2013

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The Hon Tanya Plibersek
Minister for Health and Medical Research
PO Box 6022
Parliament House
Canberra ACT 2600

Minister for Health	
25 JUL 2013	
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Dear Minister,

With almost a third of the private health insurance market in Australia, Medibank has a strong commitment to our members Australia wide and our goal of providing them with health cover that meets their needs in all stages of life.

To achieve this goal our products need to be affordable, a factor directly linked to our cost base, in particular health purchasing. In 2011/12, Medibank purchased \$4.3 billion in health services on behalf of our members, an increase of almost 9% over the previous year. Three quarters of this spending is for hospital services and as such it is vital that when negotiating the purchase of services from hospital providers we achieve sustainable prices that are fair to both our members and the provider.

In this context, since the start of the year we have been in negotiation with various hospital providers to make sure that we are paying a fair rate for hospital services. While we have reached agreement with various hospital providers we are still in discussion with the Little Company of Mary Health Care (LCM), the owner of a number of private hospitals in South Australia, Tasmania, the Australian Capital Territory and New South Wales.

At the core of the negotiation is LCM's view that rates paid for services at its South Australian hospitals are lower than those paid in other States and therefore should be substantially increased. We disagree with this simplistic argument.

As evidenced by the findings of the Productivity Commission's 2009 *Public and Private Hospitals* research report and more recent work undertaken by the Independent Hospital Pricing Authority, South Australian hospitals do indeed receive lower rates for the services they provide than some other States. However the research carried out by these organisations also makes clear that the rates paid for services in South Australia reflect the lower cost of providing healthcare in the State.

In light of this independent evidence it is our firm contention that our offer to LCM is fair and is similar to our agreements with comparable hospitals in South Australia. Nonetheless LCM has initiated a process to terminate contracts with Medibank. Unless we can reach a compromise, from 23 August 2013 Medibank members may not be fully covered against the costs of attending LCM hospitals.

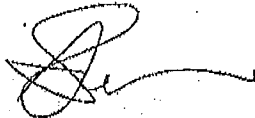
Unfortunately, in order to maximise pressure on Medibank, LCM is terminating contracts not only in South Australia but also at its four Tasmanian hospitals, two ACT hospitals and its Wagga Wagga facility. This is despite our preparedness to meet price increase demands at all non-South Australian hospitals. It is taking this approach to capitalise on its market dominance in these jurisdictions in the hope it will force us to acquiesce to its South Australian demands.

Underpinning LCM's strategy is the market distorting effect of the Second Tier Default Benefit scheme. As you know this scheme allows for uncontracted hospitals to charge health funds 85% of the rate paid to peer facilities in their State and so protect their revenue position while bringing pressure on the health fund. In theory this is a good idea to protect small and regional hospitals; in practice it allows big hospital groups like LCM to hold health funds and their members to ransom.

Medibank is currently working with your Department on a range of reforms to remove cost from the private hospital system. Reforming the Second Tier scheme is one of the highest priorities. Without reforms such as this the private health sector has little chance of getting near the CPI growth rate you aspire for us.

I would be pleased to meet with you to discuss this matter in more detail. Please do not hesitate to contact me or my team to arrange this or for further information.

Yours sincerely,



George Savvides
Managing Director